MINUTES
of the
FIFTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

November 17, 2014
Room 307, State Capitol
Santa Fe

The fifth meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2014 interim was called to order by Representative Jim R. Trujillo, chair, on Monday, November 17, 2014, at 9:40 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Rep. Jim R. Trujillo, Chair
Sen. George K. Munoz, Vice Chair
Sen. Sue Wilson Beffort
Rep. Larry A. Larrañaga
Sen. Carroll H. Leavell
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Rep. William "Bill" R. Rehm
Sen. William P. Soules
Rep. Luciano "Lucky" Varela

Absent
Sen. Jacob R. Candelaria
Sen. Steven P. Neville
Rep. Henry Kiki Saavedra

Advisory Members
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Emily Kane
Sen. Timothy M. Keller
Sen. Mary Kay Papen
Rep. Roberto "Bobby" J. Gonzales
Rep. William "Bill" J. Gray
Sen. Stuart Ingle
Rep. Tim D. Lewis
Rep. Patricia A. Lundstrom
Sen. William H. Payne
Sen. John C. Ryan
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton

Guest Legislator
Sen. Phil A. Griego

Staff
Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Ric Gaudet, LCS

Celia Ludi, Staff Attorney, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

<u>Monday, November 17</u>

Public Employees Retirement Association (PERA) and Educational Retirement Board (ERB) Status Reports and Updates Related to Governmental Accounting Standards Board (GASB) Statements 67 and 68

Jan Goodwin, executive director, ERB; Jeff Bridgens, senior manager, Moss Adams, LLP; Wayne Propst, executive director, PERA; Natalie Cordova, chief financial officer, PERA; and John Garrett, principal, Cavinaugh McDonald, LLC, gave a presentation to the committee on the implementation by the ERB and PERA of GASB Statements 67 and 68.

Mr. Bridgens summarized the changes that governments will be required to make for reporting periods beginning after June 15, 2014. The most significant change will be that governments will be required to recognize a net pension liability (NPL) in their annual financial statements, which could have a significant impact on the balance sheets of some governments. NPL, in its simple definition, consists of the total pension liability (TPL) less the fiduciary net position of a retirement fund. TPL is calculated from an accounting perspective, using a set of standard assumptions to generate an estimate of the actual liability for a given set of employees. The calculation of a fund's net position is also subject to new requirements, including the use of a blended discount rate for those pension plans deemed to have a higher-than-desired TPL. The use of a blended discount rate can have a huge impact on the NPL of a retirement system. For employers in New Mexico that participate in cost-sharing plans, each employer will be required to report its share of the overall NPL.

Mr. Garrett discussed the PERA position in relation to the new GASB statements, particularly the strict new requirement that pension plans that do not have a sufficient fiduciary net position to cover all of their liabilities will be required to use a blended discount rate to project future earnings. Those pension plans can use their selected discount rate for their assets until the assets are projected to be depleted, at which point the plans must use a much lower rate to calculate the remainder of the liability. The net result of such a calculation would be to significantly increase the NPL of such plans. Mr. Garrett said that the only pension plan under the purview of the PERA that is required to use a blended discount rate is the magistrate retirement plan. All of the other plans are able to use the PERA's investment discount rate of 7.75 percent.

Ms. Cordova discussed the PERA's implementation of the new GASB requirements.

GASB Statement 67, which requires pension plans to report NPL, will be implemented for the PERA's fiscal year 2014 financial statement. GASB Statement 68, which requires governmental employers to report their individual NPL for their pension plans, will be reported for the fiscal year 2015 financial statement. The PERA will calculate each participating employer's NPL as a percentage of the overall PERA NPL. The PERA will also assist governmental employers in preparing their financial statements, since many employers do not have the resources to correctly report pension liability.

Ms. Goodwin reported to the committee the progress that the ERB has made in implementing GASB Statements 67 and 68. The ERB has already implemented the requirements of GASB Statement 67, and it is devising a plan to assist local governments in implementing GASB Statement 68. The ERB will provide its participating employers with reports of the proportionate share of NPL, pension expense and deferred inflows and outflows. The employers, however, will need to provide member data for their reports and assume responsibility for presentation of the information used in their own financial statements. This "middle-of-the-road" assistance will significantly reduce the chance of adverse audit findings for local employers, but still requires those governments to have accurate information about their own members.

Questions and comments from committee members included the following.

- How will the new GASB requirement affect bond ratings of state and local governments? Mr. Garrett said that he does not understand why some ratings agencies started using a blended discount rate to rate some local governments' creditworthiness, which has already had a negative impact on their credit ratings.

- Will the PERA and ERB need to change some of their assumptions under the new GASB guidance? Both Mr. Propst and Ms. Goodwin said that their agencies will not need to modify their assumptions. Both agencies perform experience studies and economic assumption studies every few years.

- What is the biggest impact on local governments from the new requirements? Mr. Garrett said that previously, governments participating in cost-sharing plans were not required to report their individual NPL.

- The PERA's discount rate of 7.75 percent may be unrealistically high. Mr. Garrett said that investment professionals believe the PERA's rate is adequate, based on current projections and past experience. Ms. Goodwin said that the ERB sets its discount rate by asking five consultants to give an investment prediction for each asset class in the portfolio. The average of each estimate is then chosen and weighted according to the percent of the fund invested in each asset class.

The committee requested that the PERA and the ERB report their possible pension liabilities using a plus or minus one percent range from the selected discount rate. Mr. Propst said that he would be happy to provide that kind of analysis to the legislature. He said that the GASB statements actually require pension plans to perform such studies.

Approval of Minutes

The minutes from the October 13, 2014 meeting of the committee were approved without changes.

ERB Status Reports and Updates — Actuarial Data Regarding Solvency; Proposed Legislation

Ms. Goodwin briefly discussed with the committee the ERB's actuarial valuation for fiscal year 2014. The actuarial funded ratio of the ERB increased from 60.1 percent in fiscal year 2013 to 63.1 percent for fiscal year 2014, and the unfunded actuarial accrued liability (UAAL) decreased from $6.5 billion to $6.3 billion. The funding period dropped from 95.1 years to 42.1 years. Ms. Goodwin said that the fiscal year 2014 report represents a single point of time and does not reflect projected lower costs for future members, future cost-of-living adjustments (COLAs) of less than two percent for the foreseeable future and an expected one-half percent average increase in membership each year. Each of these benefits will be realized incrementally and cumulatively over time.

Ms. Goodwin also presented proposed legislation for the committee's consideration that would exempt from the Personnel Act future investment employees of the ERB. Ms. Goodwin said that the ERB needs to attract the best investment professionals in order to keep its fiduciary responsibility to its members intact. After a brief discussion by committee members, no action was taken on the proposed legislation. The ERB was requested to further research the issue and get input from staff of the PERA and State Investment Council (SIC) about legislation that could be jointly proposed next year.

PERA Status Reports and Updates — Actuarial Data Regarding Solvency; Proposed Legislation

Mr. Propst discussed with the committee the PERA's actuarial valuation for fiscal year 2014. The PERA's total funded ratio for fiscal year 2014 is 75.8 percent, up from fiscal year 2013's 72.9 percent funded ratio. Thirty-year projections of the funded ratio of the PERA funds have improved significantly since 2012 from a 29 percent funded ratio projection to today's 133 percent funded ratio projection. In addition, the PERA's UAAL decreased $321 million and currently stands at $4.3 billion.

Mr. Propst presented proposed legislation for the committee's consideration that would request a five-year moratorium on the proposal and consideration of legislation affecting retirement benefits administered by the PERA. The non-binding memorial requests legislators to defer acting on such legislation, except to correct an unforeseen emergency situation. Mr. Propst said that the recently enacted pension reforms need a few years of experience before making new changes to the plans. He cautioned the committee to not undo the changes made before their effects can be accurately measured and understood.

Questions and comments from committee members included the following.

- If municipalities can pay for the cost of providing return-to-work (RTW) incentives, would the PERA support such changes? Mr. Propst said that it is possible to design a RTW plan that appears revenue-neutral, but there would be many assumptions involved in the actuarial analysis.

- The mayor of Albuquerque wants to allow RTW employees again, mostly to retain qualified police officers. The legislature should only allow such a proposal in a way that does not negatively affect the PERA funds.

- How are mortality rates calculated between regular PERA members and public safety members? Mr. Garrett said that actuaries use standard mortality tables for all employees. There is no significant difference in mortality rates between regular retirees and public safety retirees, including firefighters, he said.

- How could it be bad for the PERA to provide for RTW if employees continue paying into the PERA funds, with no expectation of future benefits from those contributions? Mr. Propst said that if both the employee and employer make contributions and the COLA is suspended, it could have a neutral impact on the funds. However, the main problem with RTW is that if it is allowed, then every employee will retire at their exact retirement eligibility date, rather than waiting until their full retirement benefit has accrued. The PERA benefits by keeping employees at work as long as possible.

The committee discussed the City of Albuquerque's recent decision to provide retention pay to police officers nearing their retirement eligibility. The additional pay has had the net effect of significantly increasing the final average salary of those employees, which will negatively impact the PERA funds, because those employee retirement benefits will also be increased. Mr. Garrett said that the PERA expects to be liable for an additional $110,000 in retirement benefits over the lifetime of a retiree because of the way the retention pay was structured. In addition, the pay was given to employees before they were actually eligible to retire. He said that there are many ways to structure retention bonuses that would not affect the PERA. Mr. Propst said that the PERA is currently researching what remedies it has available to mitigate the recent decision. In some states, the pension plan is allowed to charge an entity for the costs of negatively impacting a pension fund. The general PERA membership should not be forced to pay for Albuquerque's retention pay program, he said.

The committee directed staff to draft a letter from the committee to the City of Albuquerque objecting to the negative impact on the PERA pension system from the city's retention pay program.

The committee endorsed the proposed PERA legislation.

Retiree Health Care Authority (RHCA) Status Reports and Updates — Actuarial Data Regarding Solvency; Proposed Legislation

Mark Tyndall, executive director, RHCA, briefly discussed with the committee the recent activities of the RHCA and efforts taken to ensure the Retiree Health Care Fund's long-term solvency. The last piece of the solvency puzzle involves enacting legislation to phase in over three years a three-eighths percent employee contribution increase and a three-fourths percent employer contribution increase. If this legislation is enacted, the fund is expected to be solvent through fiscal year 2040, with no deficit spending projected until 2025.

The committee took no action to endorse the proposed legislation.

SIC Status Reports and Updates — Actuarial Data Regarding Solvency; Proposed Legislation

Steven K. Moise, state investment officer, and Vince Smith, deputy state investment officer, SIC, gave the committee an update on the SIC's investment performance and also presented proposed legislation for the committee's consideration. In the first three months of the fiscal year, the total fund composite performance has actually declined .29 percent. For calendar year 2014, however, the funds have grown 5.23 percent, as of September 30.

Mr. Moise discussed a proposed bill that would make technical and administrative changes to the SIC statutes. The bill also eliminates the Private Equity Investment Advisory Committee and limits the liability of the state investment officer and the Investment Office.

The committee took no action on the proposed bill.

The second proposed bill that Mr. Moise presented would provide for increased distributions to the Severance Tax Permanent Fund (STPF) by phasing in reductions to severance tax and supplemental severance tax bonding capacity. Currently, transfers into the STPF only occur after 95 percent of the deposits into the Severance Tax Bonding Fund during the preceding fiscal year have been sold as severance tax bonds or supplemental severance tax bonds, and if there is enough money in the bonding fund to service the next two debt payments on existing bonds. This often means that transfers to the STPF are minimal. The bill would phase in reductions to bonding capacity from the current 95 percent of the previous year's deposits into the bonding fund to 85.8 percent over four years, resulting in a significant increase in transfers to the STPF. This will allow the STPF to grow steadily, which will allow for bigger distributions from the fund over time.

The committee endorsed the proposed bill.

Adjournment

There being no further business, the committee adjourned at 4:25 p.m.